



Audit Committee Report

Action Item

Recommendation: Approve Draft Independent Auditor's Reports for Fiscal Year Ended June 30, 2007.

Introduction

Government Code Section 11537 requires the Technology Services Board (TSB) to engage an independent firm of certified public accounts to conduct an annual financial audit of all accounts and transactions of the Department of Technology Services (DTS). An Invitation to Bid (IFB) was awarded to Macias Gini & O'Connell (MGO) to conduct a financial audit of the DTS for the next three fiscal years (2006/07, 2007/08 and 2008/09) for each fiscal year ending June 30th.

MGO presented the results of its audit for the Fiscal Year ended June 30, 2007, in the form of two draft reports: the *Independent Auditor's Reports and Financial Statements (Appendix A)* and the *Report to the Board of Directors (Appendix B)*.

Overview

In the *Independent Auditor's Reports and Financial Statements*, MGO is issuing an unqualified opinion. An unqualified audit opinion means that the financial statements are in conformity with Generally Accepted Accounting Principles (GAAP). Furthermore, the results of compliance testing disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

The Report to the Board of Directors contains the following four new recommendations to management to improve internal control and operations effectiveness:

1. Manual Journal Entries

- Recommendation: Manual journal entries in PeopleSoft Financial System should be prepared and posted by separate individuals to ensure adequate segregation of duties.
- Response: The DTS agrees to amend existing procedures and use the system to separate the preparing and posting of entries in the system. DTS will work



with PeopleSoft to see if there is a security feature that can be enabled to prevent the same person from preparing and posting a journal entry.

2. Capital Assets

- Recommendation: Source documents for capitalized amounts should include calculations supporting the amounts recorded in the accounting records. MGO also recommends that DTS remove capital assets from the accounting records only upon appropriate approval and that we maintain sufficient documentary evidence supporting the disposal.
- Response: The DTS agrees to maintain appropriate documentation to support the calculation of capitalized amounts and the disposal of equipment.

3. Employee Advances

- Recommendation: DTS should actively monitor advances and follow its policies related to collections as outlined in the State Payroll Procedures manual.
- Response: DTS agrees that there should be timely collection of outstanding employee advances. DTS is in the process of rewriting and tightening procedures for the collection of employee overpayments.

4. Vacation Hours

- Recommendation: DTS should monitor vacation balances and follow established policies to control future excessive accruals of vacation hours.
- Response: DTS will monitor employee vacation hours and recommend supervisors encourage staff to use vacation hours in excess of 640 hours to the extent possible while meeting ongoing business needs.

Status of Prior Year Recommendations – Fiscal Year Ending June 30, 2006

1. Inventory of Capital Assets

- Recommendation: DTS should perform a physical inventory of capital assets and reconcile the inventory counts to the financial records.
- Response (FY 2005/06): DTS is in agreement with this recommendation and is planning to conduct a statewide asset inventory of all campus facilities by the end of the calendar year.
- Status (FY 2006/07): DTS completed the statewide physical inventory of equipment in January 2008. While inventory reconciliation is currently underway, the complexity, diverse nature and multiple locations of the equipment have increased the time demands for completion. Reconciliation is anticipated to be completed in April 2008.

2. Aging of the “Due from Other Funds”

- Recommendation: DTS should continue to communicate payment terms to customers as the balance due from customers at year end was \$73.3 million.



Of this \$73.3 million, \$41.3 million or 56% was outstanding over 60 days and \$28.9 million or 39% was outstanding over 90 days.

- Response (FY 2005/06): DTS is in agreement and will continue to follow up with customer departments through collection letters and personal contact to promote payment. DTS is actively pursuing alternatives for resolving its cash flow problem. Several alternatives are being pursued, 1) proposing legislation to mandate direct transfer of payment from customers upon invoicing and 2) proposing a discount to customers who pay within 60 days.
- Status (FY 2006/07): DTS continues to be slow in collecting the amounts due from other funds. As of June 30, 2007, \$82.2 million was outstanding out of a total FY billing of \$205 million. Of the \$82.5 million total outstanding, \$29.6 million was outstanding for over 90-days and another \$3.2 million was outstanding between 61 and 90 days. DTS has rewritten its collection letters that are sent at 30-day intervals to elevate the levels to which the letters are directed.

3. Regular Change in Passwords

- Recommendation: DTS should use a standard password configuration in the network and financial application and require changes in the passwords to provide system security.
- Response (FY 2005/06): The DTS password expiration period was temporarily deactivated during the Active Directory consolidation project. Effective March 5, 2007, DTS implemented new password requirements and will require the passwords to be changed every 90-days.
- Status (FY 2006/07): DTS has published Bulletin number 3136, which sets guidelines for password standards. DTS will continue to enforce password expiration periods to user accounts, network administrator and database administrator accounts. DTS will research the possibility of discontinuing shared accounts.

4. Disaster Recovery Plan

- Recommendation: DTS should have a comprehensive business continuity and disaster recovery plan.
- Response (FY 2005/06): DTS is currently completing a business impact assessment to incorporate best practices of each previous data centers' business resumption plans. We estimate the new plan will be completed by July 1, 2007.
- Status (FY 2006/07): DTS continues to work on the Business Recovery Project. The estimated date of completion for formal procedures is June 2008.

5. Termination Policy and Computer Access

- Recommendation: DTS should develop formal procedures and perform an audit to ensure that no terminated employees or contractors retain computer access once they have left the department.



- Response (FY 2005/06): DTS agrees that its custom application called Staff Movement, which includes an automated exit clearance notification process, does not automatically delete or disable application access. DTS is in the process of tightening procedures to ensure user access is deleted expeditiously and in a secure manner.
- Status (FY 2006/07): Via notification from the DTS Staff Movement Application, DTS is now able to delete employee's access to PeopleSoft when employment is terminated.

6. Policy for Periodic Reviews

- Recommendation: DTS should develop a policy for periodic reviews of users of the financial application to ensure their authorizations are up-to-date and provide proper segregation of duties.
- Response (FY 2005/06): DTS is in agreement and is establishing a policy for conducting follow up reviews.
- Status (FY 2006/07): DTS is developing procedures for the periodic review of PeopleSoft access and authorization rights. Changes to staff duties and securities will be conveyed from the managers to the personnel assigning system access.

7. Password Protection – Configuration Policy

- Recommendation: DTS should require a minimum password configuration standard for network and application access.
- Response (FY 2005/06): The DTS password configuration policy was temporarily deactivated during the Active Directory consolidation project. Effective March 5, 2007, DTS implemented a new standard password configuration.
- Status (FY 2006/07): Strong passwords outlined in Bulletin number 3136 are being enforced within the network environment. Strong passwords are not being reformed for network and database administrators. Strong passwords will be implemented in PeopleSoft during the next upgrade which is scheduled for 2009.

8. Activity Matrix

- Recommendation: DTS should periodically evaluate IT activities against defined metrics and report to senior management.
- Response (FY 2005/06): DTS is in agreement and plans to begin working on metrics and procedures by June 2007.
- Status (FY 2006/07): DTS is currently working with an outside expert to assist with the development of broad performance metrics program. Due to other critical priorities at this time, this project is on hold until late 2008.